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## DEFENSE PROCUREMENT—A COMPLEX OF CONFLICTS AND TENSIONS

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The defense procurement of the United States reaches directly or indirectly into the lives of every inhabitant, young or old, in every state and territory of our nation. It is of vast proportions, giving employment to many millions of people and spending nearly one-fourth of each year's federal cash expenditures.<sup>1</sup> Paradoxically, however, it is one of the least discussed, the least studied and the least understood facets of our national life. Even within the agencies of the government which conduct such procurement, and in the industrial complex which serves it, disputes often arise which seem to indicate recurrent lack of appreciation on both sides of the bargaining table of the complex problems each is encountering.

It is the thesis of this article that there has developed, within the field of defense procurement, a complex of conflicts and tensions of which most people are only dimly aware; but that a recognition of these and of their implications is a prerequisite to any intelligent appraisal by an

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<sup>1</sup> In the budget now before Congress for the 1963-64 fiscal year, the Defense Department has requested forty-seven billion dollars. Of this, about \$17 billion will be for installations, maintenance, payrolls and related expenditures, and the balance of about \$30 billion will be for new purchases of services and material. This is one-third of the total budget requests of \$90 billion and one-quarter of the projected cash outlays of \$120 billion. The source of this data is the President's budget message to Congress.

No accurate source of data exists for total employment caused by defense procurement, but industrialists are satisfied if each employee produces an average of \$15,000 per year of sales. On this ratio \$30 billion of expenditures equals 2,000,000 employees, plus all who work for the Army, Navy, Air Force, Marine Corps and Defense Department in this field.

It should also be noted that the above data make no inclusions for the Atomic Energy Commission (AEC) or for the National Space Agency (NASA), whose expenditures will probably aggregate another eight to ten billion dollars in fiscal 1963-64.

informed and alert citizenry of the posture of our defenses and the effects of our defense procurement upon our economy and our free enterprise system.

#### THE ORIGINS OF OUR PRESENT SYSTEMS OF PROCUREMENT

Defense procurement today is conducted under the authority of the Armed Services Procurement Act of 1947, which has had some, though remarkably few, amendments since its enactment. In its legislative history lie some of the seeds of present day problems.

When World War II burst upon the United States, the basic military procurement statute<sup>2</sup> provided that almost all such procurement must be on firm fixed-price contracts let after formal advertised competitive bidding. It was at once apparent that such a slow, ponderous and publicly exposed technique was useless and dangerous in times of national peril. The First and Second War Powers Acts were passed, granting almost unlimited powers to the President, who in turn, via many "executive orders," passed authority down to such departments as the Army, Navy and others. Under these broad directives, many new, and therefore untried, methods and techniques of procurement were devised and widely used. These included the choice of several kinds of contracts, the use of plant surveys, the enlarged use of audit agencies, the furnishing of government tools and equipment, the application of techniques of price analysis and many more. Under specific acts of Congress, annual statutory renegotiation was instituted, and negotiated settlements of terminations for convenience were allowed. Surveillance began not only of prime contractors, but also of subcontractors, and beginnings were made toward the acquisition of rights to use patents and trade secrets of private contractors.

It is a curious and remarkable fact that hardly any of these new techniques or practices were ever attacked on the ground that there was no statutory or constitutional authority for their usage. Perhaps this is because no one wanted to delay the war effort, or to so threaten, by bringing such litigation, but more likely the reasons for this lie in a combination of the general fairness of the unilateral settlements made by the Services, either through negotiation or their Boards of Contract Appeals, of disputes with their contractors, and the unwillingness of individual contractors to sue such a large and important customer.

When World War II ended, it was unthinkable to return to the archaic forms of pre-war military procurement, and thereby abandon the valuable lessons learned about new methods and techniques. The Honorable James Forrestal, then still Secretary of the Navy, led a team of military and civilian procurement specialists in the prepara-

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<sup>2</sup> Rev. Stat. § 3709 (1875).

tion of a new statute to propose to Congress to replace the pre-war statutes which would become operative upon the expiration of the War Powers Acts. Early in the course of the discussions with Congressional leaders about such a statute, it became apparent that many members of Congress had a deep-seated suspicion of any procurement method differing from the traditional advertised competitive bidding. To assuage these fears, and to facilitate favorable action upon the new statute, the bill was phrased so as to require all procurement to be by advertised competitive bidding except in any one of seventeen stated sets of circumstances, under which negotiated procurement was authorized. This has had the effect of leaving a large percentage<sup>3</sup> of the number of purchases still subject to advertised bidding, but placing the larger dollar value of orders under negotiated procurement.<sup>4</sup>

To this day, this has created conflicts between individual members of Congress or Congressional Committees, on the one hand, and the Armed Services, on the other. The former, sometimes supported by General Accounting Office reports which purport (by hindsight) to find inefficiencies resulting in "excessive profits," insist that the Services buy more by advertised bidding and less by negotiation, or assert that no true or effective competition is possible under negotiation. The Services reply, however, that until a product's design specifications are known and frozen, and are within the capabilities of several manufacturers to make, advertised bidding is impossible and dangerous. They also have shown that competition between multiple bidders in negotiated procurements can be even more intense and effective, because it applies competition to design performance, and speed of delivery, as well as price.

Defense industrialists largely support the views of the Services in these arguments, knowing full well that under a negotiated procurement, the Services can "keep the heat" on them in every way throughout performance, whereas under advertised bidding, delivering a product which meets the specifications on time is all that is required.

Continual Congressional pressures, however, have tended to drive the Services to advertised procurements too early in the procurement cycle. If investigations in depth of such cases were possible, it would not be surprising to find that the aggregate costs to the government, as well as delivery delays, were increased greatly by such premature actions. These cases, however, are rarely investigated, because their findings would not be compatible with the politically fixed ideas of some members of Congress and of the General Accounting Office.

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<sup>3</sup> Now estimated to over 75%, per Department of Defense (DOD) presentations to annual hearings of Procurement Subcommittee of the Senate Committee on Armed Services.

<sup>4</sup> Now in excess of 80%, per DOD presentations, *op. cit.* supra note 3.

## THE FETISH OF COMPETITION

Each of the Armed Services and the Department of Defense are, however, deeply committed to creating competition as early as possible in the procurement cycle, merely preferring negotiation as a technique to reach this end. Competition, to them, is historically and mainly price competition—with the laudable, and indeed mandatory, purpose of obtaining the most possible for each defense dollar spent. Recently, however, this has—in some cases—been extended to design competition or to meeting performance as well as delivery schedules. In a few very large systems projects, these different factors are weighted, as are such things as ability to supply interchangeable parts and to service and maintain the equipment more economically. Awards are then made on the basis of the most favorable composite of all factors.

These can, of course, lead to spectacular arguments and investigations. The most recent one to hit the headlines is the TFX fighter plane program—awarded by the Secretary of Defense's direction to one bidder despite the particular Service's recommendation of another.<sup>5</sup> At once, investigations were begun at the behest of the members of Congress who represent the areas where the unsuccessful bidder has its facilities.<sup>6</sup> This case was, no matter how one views it, an exercise of judgment, and none of those close to the decision would say otherwise, whether they agree with its outcome, or not. To try to weigh and evaluate so many complex factors is a bold task, and any decision is a courageous one.

Unfortunately, in smaller and less newsworthy procurements, price alone is often the only deciding factor, and to many contracting officers, the use of any means to a lower price is justified by their obligation to "the taxpayers." Every defense contractor knows of cases where other supposed rights have been sacrificed on this altar of lower price. One contractor's original designs, incorporating trade secrets or data deemed in common law to be protected by proprietary rights, are turned over to another bidder who, having no design costs to amortize (and often no knowledge of the impending pitfalls of production), underbids the designer. The Comptroller General has ruled<sup>7</sup> that if a responsible bidder is low in price, it is entitled to an award even if it is known that the low bidder proposes to infringe the patents of another bidder, who is left to recover damages, if he can, from the successful infringer.

This fetish for price competition has also led to the creation—

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<sup>5</sup> The award was made to General Dynamics Corp.; the Air Force had recommended Boeing Company.

<sup>6</sup> Hearings were held in April 1963 before Senator McClellan's subcommittee of the Armed Services Committee of the Senate.

<sup>7</sup> Decision B-139585, 2 July 1959, of the Comptroller General.

## PROCUREMENT CONFLICTS AND TENSIONS

often at government expense—of duplicate production facilities, with stocks of special tooling, far in excess of total production needs, merely to create second and third sources of supply to compete with the original producer.<sup>8</sup> This could, perhaps, sometimes be justified on grounds of plant dispersion against attack, but such planning has had little financial support from Congress.

Every taxpayer wants the defense dollar spent wisely, but many might feel wisdom is not displayed when prices are shaded at the expense of fundamental private rights, or when indirect costs exceed the "savings" from lower prices. Indirect costs are created by multiple sources—more spare parts must be bought, catalogued and stockpiled; drawings and maintenance and service data are duplicated; new production personnel must be trained even as trained ones are idled; new groups of subcontractors must be found and trained.

The fetish of competition is then, at least in part, a chimera, and a false idol not to be worshiped blindly. Its true value lies in the incentive it creates to do a better, cheaper job—if this is not clearly the result of its exercise, its values may often prove to be wholly illusory. There are signs that this is beginning to be recognized in the Defense Department—but the old "god" is still being worshiped on "the Hill."<sup>9</sup>

### PROCUREMENT REGULATIONS

It has become common practice for an Executive Department, when authorized to perform acts under a statute, to issue rules or regulations as to how such actions are to be carried out. Thus, very soon after the enactment of the Armed Services Procurement Act of 1947, administrative regulations began to appear to interpret, explain and enlarge upon the statute. At first, these were issued by each of the three Services separately, and as might be expected their regulations were not always compatible or in agreement.

Shortly after the reorganization of the Defense Department as a result of the so-called Key West Meetings,<sup>10</sup> jurisdictional cognizance of the Armed Services Procurement Regulation (ASPR) Committee was transferred from the old Munitions Board to the Office of the Assistant Secretary of Defense (Supply and Logistics),<sup>11</sup> and it was reconstituted to formulate all new sections of ASPR and all revisions to the initially issued sections of it. This Committee, today, is chaired by a military officer of the rank of Colonel or the equivalent, and is

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<sup>8</sup> Many examples could be cited. One of the more recent is the Army M-14 rifle program, involving three plants with government-furnished facilities and tooling. One is now wholly idle.

<sup>9</sup> The Congress, on Capitol Hill.

<sup>10</sup> In February, 1949, leading to the Amendments to the National Security Act of 1949.

<sup>11</sup> Now the Assistant Secretary of Defense, Installations and Logistics (ASD(I&L)).

composed of representatives of the procurement and legal branches of each of the three Services, the ASD (I&L) and the Defense Department Comptroller's Office. It has a permanent staff of civil servant employees, and also functions through various working subcommittees of both a permanent and *ad hoc* nature.

Ostensibly, this Committee's work is reviewable only within the Defense Department hierarchy, and when it promulgates regulations, all other regulations of the separate Services must in no way revise or alter the basic ASPR. Unfortunately, it does not always work this way—for each Service Department Secretary has an intervening veto authority between the level of ASD (I&L) and the Under Secretary of Defense.<sup>12</sup> Obviously, the Under Secretary and Secretary do not have enough hours to meet all their other responsibilities and also to resolve all detailed disputes or disagreements among the Services' representatives on the ASPR Committee.<sup>13</sup> The Committee, recognizing this, thus tends to operate under a rule of unanimity. In short, major issues are not resolved—they are compromised, even though compromise does not always lead to right or courageous decisions. Should compromise prove impossible, nothing is done, unless and until the Secretary or his Deputy steps in to make the decisions.

These organizational nuances make life difficult for those in the ASPR Committee function, and for those industrial or trade association representatives who attempt to digest and interpret business and industrial viewpoints for the Committee and its subcommittees. There are, however, even more fundamental and far-reaching aspects of the system which ASPR have created which need examination.

ASPR now consist of seventeen sections, aggregating 1726 closely printed pages; in addition, there are six appendices, aggregating 397 more printed pages. Each of the three Services has its own regulations of equal or greater length, which, though largely repetitive, are not entirely so.<sup>14</sup> The sheer bulk of these documents impairs their usefulness, and even if wholly inadvertent, assures discrepancies. But worse, however, is the fact that new or revised regulations are uniformly made applicable as of a fixed date, but the ASPR date does not necessarily become the AFPI date, and the others may become effective at

<sup>12</sup> This, too, stems back to the Key West Meetings. At these, the Service Secretaries were demoted to sub-Cabinet rank, leaving only the Secretary of Defense on the Cabinet. As a compensating gesture, their rank was made higher than all Assistant Secretaries of Defense.

<sup>13</sup> This was done to promulgate finally the ASPR provisions on Cost Principles, ASPR, 32 C.F.R. §§ 15.000 to 15.603, after three years of disagreements between procurement officials, representatives of audit agencies and financial officers, and almost 100% of industry spokesmen who were vocal on the subject.

<sup>14</sup> Air Force Procurement Instructions (AFPI)—approx. 700 pages. Navy Procurement Regulations (NPR)—approx. 200 pages. Army Procurement Policies (APP)—approx. 350 pages.

still different times. Thus new policy may take weeks or months to get into the particular writing which is the only "law" to a lowly contracting officer in a particular Service's remote office.

Furthermore, some important ASPR provisions have, upon issuance, been made applicable to already outstanding contracts in the process of performance or settlement, without providing for any additional costs caused to the complying contractor or additional appropriations to the Services to cover such costs.<sup>15</sup>

It is arguable as to whether all of ASPR's provisions are "fair and reasonable" and issuable under the express or implied authority of the Armed Services Procurement Act of 1947 or other statutes. It is a hodge-podge of pure policy, general observations, detailed instructions (some permissive and some mandatory), contract clauses (some permissive and some mandatory), auditor's manual and internal procedural directives. While it contains provisions for approval of deviations,<sup>16</sup> the procedures are—probably of necessity—so long and time-consuming that they are seldom used or useful.

It is in ASPR, aided and abetted by the Services' individual regulations and directives, that onerous provisions have been imposed which many defense contractors believe are invading proper managerial functions or are undermining contractual rights. ASPR are replete with clauses which might be cited as examples of these, but only a few will be touched upon to illustrate these points.

#### ENCROACHMENTS ON MANAGEMENT PREROGATIVES

Make-or-buy decisions, and choices of vendors and subcontractors, go to the heart of a prime contractor's ability to perform a contract well and on time, and to guarantee the finally assembled end-product. Crises during performance may necessitate changes in such decisions, or enlargement either of in-plant or subcontracted performance. Yet recent additions to ASPR<sup>17</sup> require that in some contracts, make-or-buy programs and subcontract choices be approved as a part of initial negotiations and in advance of starting work, and thereafter changed only with the contracting officer's prior approval. Other provisions<sup>18</sup> subject a prime contractor's purchasing system to survey and approval prior to contract award or periodically thereafter, and require reviews and approvals of individual subcontracts.

Inspection and quality control, throughout production and in

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<sup>15</sup> An example is the original provisions in ASPR requiring the advance approval of the use of overtime or the payment of overtime premiums if such costs were to be allowable. For current regulations treating overtime, see ASPR, 32 C.F.R. § 12.102 (Supp. 1963).

<sup>16</sup> ASPR, 32 C.F.R. § 1.109 (Supp. 1963).

<sup>17</sup> ASPR, 32 C.F.R. § 3.902 (Supp. 1963).

<sup>18</sup> ASPR, 32 C.F.R. § 3.903 (Supp. 1963).



advance of submission for final inspection, acceptance and delivery, have long been considered vital to a contractor's control of his own products, costs and reputation. The regulations require, in some instances, the maintenance of an inspection and quality control system "acceptable to the Government," and give government inspectors the duty to "plan and conduct systematic evaluation and verification of suppliers' inspection systems, [etc.] . . ."<sup>19</sup>

When and to what extent overtime or multiple shifts are to be scheduled is usually a function of a plant's total obligations. ASPR<sup>20</sup> make many of the costs of such overtime, or of shift pay differentials, unallowable unless prior approval of such scheduling is obtained.

Every management is, or should be, conscious of costs and anxious to hold them at or below competitive levels. Yet many types of costs are either inevitably incurred,<sup>21</sup> or desirably incurred<sup>22</sup> or necessary to support the functions of the community in which a company operates.<sup>23</sup> ASPR disallow, in whole or in part, some twenty-two elements of costs of these and other types, and subjects nineteen other cost elements to special review looking toward possible partial disallowance,<sup>24</sup> despite the fact that each of these is, and has historically been recognized as, a "cost" both in accepted commercial accounting principles and for purposes of federal income tax computation. The effects of such disallowances are, of course, to throw the recovery of such costs entirely on non-government revenues (even though they are fairly allocable to government contracts) or to diminish true profits while distorting upward apparent profits on government contracts.<sup>25</sup> Many of the head-

<sup>19</sup> ASPR, 32 C.F.R. § 14.104 (Supp. 1963). See also, ASPR, 32 C.F.R. § 7.104-28 (Supp. 1963).

<sup>20</sup> ASPR, 32 C.F.R. § 12.102 (Supp. 1963).

<sup>21</sup> Costs for organization, holding of stockholder meetings, issuance of stock, etc.

<sup>22</sup> Advertising, moving expenses to new employees, etc.

<sup>23</sup> Civil defense expenditures, contributions to community chests and colleges, etc.

<sup>24</sup> ASPR, 32 C.F.R. §§ 15.205-1, 205-2, 205-5, 205-6, 205-7, 205-8, 205-9, 205-11, 205-12, 205-13, 205-15, 205-16, 205-17, 205-19, 205-22, 205-23, 205-29, 205-31, 205-32, 205-33, 205-41, 205-42 (Supp. 1963).

<sup>25</sup> Example:

	Contract Price	Pre-tax Actual Costs	Actual Profit	
Government	\$1,000,000	\$ 900,000	\$100,000—	10%
Commercial	1,000,000	950,000	50,000—	5%
Totals	\$2,000,000	\$1,850,000	\$150,000—	7½%
	Government Allowed Costs	Government Profit Shown	"Excess Profit" Recaptured	Profit Result
Government	\$ 850,000	\$150,000—15%	\$50,000	\$100,000
Commercial	950,000	50,000— 5%		—0—
Totals	\$1,800,000	\$200,000—10%		\$100,000—5%

By the government's disallowance and recapture of alleged "excessive profits," rendered

lines about "excessive profits," generating from General Accounting Office reports to Congress, are, upon analysis, profits distorted upward by the disregarding or disallowance of truly incurred reasonable and allocable costs.

### SEIZURE OF PROPERTY

One of the most complex problems dealt with in ASPR is the treatment of patents, copyrights and technical data.<sup>26</sup> It has long been the policy of the Defense Department and of the Armed Services, as to patents and copyrights owned by a contractor but originating from the performance of a military order, to require a royalty-free, non-exclusive license for government end-use. Few if any contractors have objected to this, especially since historically the Armed Services have respected outstanding background patent rights and paid minimum royalties for their use. The recent awards to prospective infringers, mentioned earlier, are the first break in the respect given patents.

This has not been true in all governmental procurement. When the Atomic Energy Commission was established, it was provided that all patents arising from its contracts became the property of the government, and not of the AEC's contractors.<sup>27</sup> No doubt this policy originated partly from the high security classifications under which such contracts were performed, and partly from a fear of having such awesome knowledge, power and rights in private hands. Later, when the National Space Administration (NASA) was authorized to conduct its own procurement, Congressional sponsors of government ownership were successful in requiring NASA contractors to give the government ownership of patents, subject to limited powers to release them back to the inventors.<sup>28</sup> In the debates over whether the NASA system should revert to the military system, or the military to the NASA system, clear cleavages developed between those advocating public ownership of all patents and those wanting a preservation of the private ownership of patents contemplated by the Constitution.<sup>29</sup> Business spokesmen, of course, ardently advocate the latter, and while somewhat lukewarm on the issue, the Defense Department has gone on record as desiring to preserve the status quo.<sup>30</sup>

Not so, however, on the problems of proprietary data. Here the Defense Department wants, by contractual fiat and without compensa-

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"excessive" by disallowance of \$50,000 of actually incurred costs, these costs must be recovered from commercial profits, and reduce total profits, before taxes, to 5%—and after a 52% Federal corporation tax, to less than 2½% on sales.

<sup>26</sup> ASPR, 32 C.F.R. §§ 10.101 to 10.703 (Supp. 1963).

<sup>27</sup> Atomic Energy Act, 68 Stat. 921 (1954), 42 U.S.C. § 2181 (Supp. IV, 1962).

<sup>28</sup> National Aeronautics and Space Act, 72 Stat. 426 (1958), 42 U.S.C. § 2457 (1958).

<sup>29</sup> U.S. Const. art. I, § 8.

<sup>30</sup> Testimony of DOD officials before Patents Subcommittee of the Senate Judiciary Committee, April 1961; digested in 17 Weekly Report to Electronics Industry, No. 15, Electronics Industry Ass'n.

tion (except possibly as to background data), to acquire all it can get, whether present needs for it are known to exist or not. Its real compulsion seems to be the desire to be free and able to turn over to new or additional sources everything needed from the original source to allow the newcomers to manufacture the product and provide competition to the originator. To the extent this requires the sacrifice without compensation of secret processes, trade secrets, manufacturing "know-how" and production techniques, the originators of data oppose DOD policy strenuously—not only because they do not want to set up competitors, but also because at common law such data has been held to be property of value entitled to protection and, finally, because such data is never wholly generated in performing a single contract, but rather represents an accumulation of knowledge over the contractor's total experience and operations.

In between these extremes, however, there is clearly a need within the Services for such data, for a variety of demonstrable and legitimate requirements. Typical of these are the data required for the manufacture and supply of replacement parts, the identification of the product and its parts in catalogs and instruction manuals, the differentiation of it from other products and the description of it and its qualities in specifications.

Despite sincere efforts extending over many years, industry and the ASPR Committee seem no nearer solutions of these problems, and the vocal Congressional cry for patent ownership spurs DOD advocates of data ownership to greater lengths. They now are proposing to reach through the prime to secure the data generated by successive tiers of subcontractors. Despite the limitations upon this now embodied in ASPR, the contracts imposed on the prime contractors in the notorious TFX procurement demand such data from the subcontractors.<sup>31</sup>

#### ASPR AS A MODEL

No other agency of the government has been as active or as prolific in the promulgation of procurement regulations as has the Defense Department and the three Armed Services. It is natural, therefore, that other parts of the federal hierarchy have tended to adapt the ASPR provisions to their own procurement, sometimes verbatim and sometimes revised to suit their own terminology or their own statutory procurement authorizations.

Thus we see the Defense Supply Agency's regulations, those of the General Services Administration, and even those of the Atomic Energy Commission and of the National Space Administration closely

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<sup>31</sup> Letter From National Security Industrial Association to Hon. K. E. Be Lieu, Assistant Secretary of the Navy (I&L), March 7, 1963, commenting on clauses in Navy TFX contract (copy circulated to NSIA members).

adopting or following ASPR's lead. Because of this, ASPR may usually be the bellwether of governmental policies and intentions. It deserves every citizen's watchful and critical eye!

PLANNING FOR DEFENSE PROCUREMENT<sup>32</sup>

The defense establishment of the United States maintains many large fixed installations at home and abroad, which must be serviced and maintained, as well as its vast supplies of military equipment for attack or defense on land, in the air and space, and on and under the sea. The supplies and services and manpower needed to provide such maintenance become, in effect, annual fixed charges in the United States budget. In addition to these expenditures, and the planning that goes into them, each of the Services as well as the Atomic Energy Commission are pressing ahead in enlarging scientific knowledge, adapting this knowledge to new or improved military equipment and regularly replacing old but serviceable equipment made obsolete by such improvements.

The annual requirements for manpower and equipment stem basically from top-level judgments of what our dangers are and will be in the months and years ahead. These include evaluations by the State Department, Defense Department, Central Intelligence Agency, National Security Council and Joint Chiefs of Staff. The conclusions reached are translated into military plans by the Joint Chiefs, and thence into equipment and manpower needs by the operational staffs of each Service. The aggregate costs of these needs are then estimated, and tabulated under the guidance of the Comptroller of the Defense Department and put into budget proposals for submission to Congress.

Almost inevitably, the sum of these cost estimates is greater than any amount which the President and his advisers would propose or which the Congress would accept, because they must appraise what the nation's economy can bear and what will be politically acceptable to the public. In forming these judgments, the President is guided by many voices, including his economic advisors, the Secretary of the Treasury and the Secretary of Commerce. Defense budgets must be added to all other budgets for government operations. In short, everyone gets into the act—and it is only natural that every Department, just like each of the Armed Services, wants none of its projects or proposals reduced or eliminated.

Under these circumstances, the ultimate decision-making must be at very high levels, and somewhat autocratic and dogmatic. Strong leadership, such as has been taken by Defense Secretary Robert Mc-

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<sup>32</sup> It will quickly be apparent that this segment of this article is a vast over-simplification of one of the most intricate phases of government, but it is hoped enough will be said to justify conclusions drawn later.

Namara, inevitably offends some both within and without the Defense Department, whether or not his decisions prove ultimately to have been right or wrong. The danger is that the recommendations or decisions will be made, whether by an individual or a group, without a complete and accurate picture of the facts and appraisals of the alternatives flowing from different decisions.

After all this is done, and the budget is before Congress for action, there still remains the political interplay, in-fighting and trading-off that goes on in Congressional committees and anterooms in order to produce a budget that will be voted into effect. Many of our best informed experts on military budgets and expenditures are Representatives and Senators in the Congress, but it is impossible for every Congressman to be so well equipped to make final judgments. Because of their complexity, and importance to national safety, military budgets probably fare better at the hands of the Congress than any other segment of the total annual budget, but they often do evoke major differences between Congress and the Defense Department.<sup>33</sup>

#### FINANCING DEFENSE PROCUREMENT

A defense budget does not merely authorize the Defense Department to spend a stated sum of dollars. Rather it is a composite of many separate budgets, few of which are actually administered by any official of the Defense Department. Most of these are budgets for certain kinds or classes of expenditures by one of the subdivisions<sup>34</sup> of the Services. There exists, therefore, a Comptroller organization within each of the Services, with representatives in each of their subdivisions where separate budgets are spent and administered. These are required to follow the policy directives of the Comptroller of the Defense Department, but are under the command of the Assistant Secretary of the particular Service who is responsible for financial management.

Each of these Bureau, Corps or Command Comptrollers, through his staff, actually administers the budget assigned to his jurisdiction, allocating funds for new contract placements, approving disbursements against his budget and shifting funds to keep within budget ceilings (to the extent allowed by law). The expenditure reports flow to the offices of the Departmental superiors, and thence to the Comptroller of the Defense Department for informational purposes.

Occasionally, however, fiscal crises loom larger and beyond the

<sup>33</sup> Typical examples have been: (a) the insistence by Congress that budgets include funds to continue the RS 70 aircraft program when DOD recommended its termination; (b) the provision of funds for aircraft carriers when DOD recommended more SAC bombers instead; or (c) the reluctance to provide funds for the "Pine Tree" radar warning network in addition to the DEW Line.

<sup>34</sup> Such as the Army's "Corps," or the Navy's "Bureaus" or the Air Force's "Commands."

mere administration of annual budgets. These may be intramural and narrow in scope, such as finding funds to cover major contractual upward repricing; or they may be national in scope, such as helping to keep total government debt within the statutory debt ceilings by reducing or delaying current expenditures; or they may be international in scope, such as reducing the number of overseas dependents of military personnel to contribute to reductions in the outward flow of gold reserves.

Every defense contract usually has some payment withholding provisions in it. Sometimes these are cumulative, and sometimes they are subject to a percentage ceiling in the aggregate. These are intended to be an incentive toward completion of contract obligations, so that payments can be concluded. They are not meant to facilitate the juggling of funds from one project to another or to further national fiscal policies.

Nevertheless, in the past<sup>35</sup> payments due on outstanding contracts have been totally suspended, or the rates of progress payments have been reduced below the rates negotiated and specified in contracts, or additional withholdings beyond stated ceilings have been made, all because of temporary fiscal or debt ceiling crises. These actions have usually been instituted through the Comptrollers of the Services, rather than through contracting officers—and in several instances, were never reflected in contract modifications.

These are not regular or common actions, but were exceptional moves made under fiscal or financial stress. They show, however, the lengths to which the Services can and have gone to meet their financial problems by unilateral, unauthorized breaches of contract terms, sometimes accomplished without even going through contracting channels in their own departments.

#### FRAGMENTATION OF AUTHORITY

The sheer bulk of actions which must be taken in connection with defense procurement dictates a spread out, decentralized organization. There is no other way to get so much done. The procurement activities of the Services are carried out all over the world, and in many instances, a long distance geographically from the policy-making headquarters in Washington.

There is, however, no real decentralization of ultimate authority—only a decentralization for carrying on routine matters covered by routine and specific regulations or instructions. All actions, therefore, tend to become routine, and the different or unusual is avoided wherever possible.

Military tradition includes the concept of monolithic, autocratic

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<sup>35</sup> Notably during the debt ceiling crisis in 1957.

command. Thus a centralization of ultimate authority fits and is acceptable within this tradition. There is more to it than that, however. The Constitution makes the President the Commander-in-Chief of all the Armed Services, and the Secretary of Defense and Joint Chiefs of Staff report directly to him. The Congress looks to these two for all information, facts and reports about procurement—and by statute has charged the Defense Department with responsibility for policy formulation and enforcement<sup>30</sup>—subject only to the higher status of Service Secretaries over Assistant Secretaries of Defense, to which reference has already been made.

In view of this, all tough decisions or ones involving major policy or large amounts of money eventually flow up to at least Assistant Secretarial levels in each department and in DOD. Those below this rank, however willing and able they may be to make decisions and accept responsibility for them, often cannot do so. But even more significant is the way the functional activities begin to split apart just below Assistant Secretary level. Wherever there is a fragmentation of authority, no one man can make total or final decisions. Also, no such person with only partial authority is anxious to propose short cuts or new methods which invade another office's sphere of influence.

Therefore, in military procurement's organizational structure, there are built-in bottlenecks to speedy action because of the many fragmented sections which have to act—and there are also built-in roadblocks to experimentation and deviation or change, because the papers for approval would have to pass up and over and back through so many pairs of hands.

Even though policy-making is centralized in the DOD Secretariat levels, and is well delegated within DOD itself, it has already been seen in connection with the ASPR Committee that the intervening authority of Department Secretaries subjects policy formulation, in fact, to the rule of unanimity, *i.e.*, compromise.

The geographical dispersion of military procurement also tends to formality and exchanges of writings and memoranda because the informality of settling things orally and face-to-face is lost. In this connection, however, it should be pointed out that the Navy, through centralization in Washington, has not been so subject to this as have the other Services.

#### POLITICS

Politics plays a large and continuing role in defense procurement. It can take many forms; some direct, some indirect; some patriotic, some self-seeking.

<sup>30</sup> Dept. of Defense Reorganization Act, 72 Stat. 514 (1958), 50 U.S.C. § 401 (Supp. IV, 1962) and Act of Organization, 10 U.S.C. § 2202 (1958).

Of course, the impact of thirty billion dollars' expenditures for goods and services in one year is tremendous, and every politician would like to see some of it go to his district or state, and get some credit for it. Hence, the public announcement of most large defense contract awards is made via the cognizant Representatives or Senators, preferably of the party then in power in the presidency. This is relatively innocuous, but it remains true that few contracts of any complexity can be negotiated or obtained via the halls of the House or Senate Office Buildings. Their intervention is often taken by junior government personnel in the services as interference or an attempt at special influence, or as a threat for future investigation, however scrupulous the Congressman's approach may be.

At least three types of social problems, each with political overtones, are required to be considered in placing defense contracts, even though any of them might be diametrically opposed to making the best choice of supplier. These are the set-asides and other favored treatment given to "small business" (artificially and varyingly defined), the special attention to placing contracts in "depressed labor areas" (as determined by the Labor Department), and compliance with the Buy American Act (which operates to give American labor a twenty-five per cent subsidy against foreign labor costs). Within this category, too, might be placed promises made by candidates during political campaigns to get more defense contracts for their listeners,<sup>37</sup> although such promises are not yet ensconced in statutes or regulations!

Other more important aspects of politics' effects on defense procurement are found in the relationships between Congress and the Defense Department and the three Armed Services. There is much respect between these legislative and executive departments, but on occasion, there is much friction and resentment, too. Regularly, Congressional committees and sub-committees hold hearings about defense procurement. Often, the work and the areas of interest of these separate committees overlap and cause the duplication of testimony by DOD and Service personnel. The time such personnel spend back at their offices in the preparation of testimony, charts and exhibits, or the assembly of data requested to be in certain forms, the searching of files, the briefing of witnesses and the policy clearance of the statements to be made, is prodigious and undoubtedly runs into thousands of man hours per year. The time of top level officials and their immediate staffs in giving actual testimony at hearings is also burden-

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<sup>37</sup> Examples:

Candidate D. D. Eisenhower to Lawrence, Mass. rally in 1952.

Candidate J. F. Kennedy to West Virginia audiences in 1960.

Candidate E. M. Kennedy's slogan "I Can Do More for Massachusetts" in his 1962 Senatorial campaign.



some to the extent it interferes with their other regular duties. This is often prolonged by the desirability of explaining terms, background, technological data and other facts to new or relatively uninformed committee members. If sharp disagreements occur between witnesses and committee members, personal accusations have sometimes been made unworthy of both parties.

The General Accounting Office is an agency of the Congress, and is the chief investigative agency for its committees in procurement matters, especially as to prices, costs, accounting data, etc. It always has, in such reports, the benefit of hindsight. It does not hesitate to recommend changes of policy or of procurement practices which will affect all defense suppliers, on the basis of fragmentary or isolated instances of apparent laxity or impropriety. These reports embarrass the Services and their personnel, and are always critical, because no reports are made of investigations which show that all was well. Many criticisms could be explained away by government or contractor personnel, but their views are not always solicited or reported.

It is difficult to assess the value of continuing, untrammelled, wide-open and prolonged Congressional Committee hearings. They seem to be less frequent and less virulent when the control of the executive and legislative branches of the government are in the same political party's hands, although with the liberal-conservative split which now exists in each party, these lines are not clearly drawn. Surely the power of investigation is a vital and important one to preserve for Congress, for it is its chief public way to hear testimony from all viewpoints, and to assay the need for and effects of legislative action. On the other hand, their prolific and repetitive nature has undoubtedly interfered with, and on occasion delayed, the orderly handling of defense procurement.<sup>38</sup>

#### BUSINESS REALIGNMENTS

Over the past eighteen years, since World War II ended, defense business has become a very large, important and probably permanent segment of our economy. It consists basically of something less than five hundred corporations able and willing to take either prime contracts or subcontracts, and another one thousand able and willing to take subcontracts. With the advent and growth of placing complete systems responsibility in one large prime contractor, many new management, control and review techniques have been devised to facilitate

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<sup>38</sup> Armed Forces Management, June 1963, p. 11, comments additionally as follows on the McClellan Subcommittee's hearings on the placement of the TFX program:

While McClellan fiddles, the TFX falters. In short, the Committee has done little more than hamper the acquisition of a new fighter, superior to anything currently in the inventory. Their decision has done more to harm this program and undermine unification and the Defense Secretary than anything done by the Secretary's office since its creation in 1947.

exchange of status and fiscal information between the prime contractor and the Service department concerned. As the Services have tended more and more to delegate to the systems manager the purchasing and coordinating functions formerly performed by the government, their personnel fear that failure or blame for less than perfect pricing and performance will come back to their detriment. Therefore, control and reporting requirements have been substantially enlarged, as have the right of prior reviews and approvals by Service personnel of many normal managerial functions.

At the same time, there have grown up new problems in relationships between prime contractors and their subcontractors. No longer are the latter all small and usually nearby firms. Today many of the largest and most powerful companies are subcontractors to smaller firms. In many instances, commercial competitors are in prime-sub relationships, and they are unwilling to submit their cost data, their know-how, their purchasing techniques or their coteries of suppliers to the files of a competitor.

Still smaller and newer firms, often with a business based upon special engineering or developmental break-throughs, contribute to successful systems design and production, but to expect these firms to turn over freely to other commercial concerns the special knowledge that is their life-blood is both unfair and unrealistic.

#### PROFIT LIMITATION AND RECAPTURE

Business, in our free enterprise system, cannot live without profit. Free competition of the market place sets the scale of profits each product or class of products can generate—but not so in defense procurement. The Armed Services Procurement Act of 1947 sets limits of fees which can be fixed in cost plus fixed-fee contracts. ASPR effectively reduce these by a third, and Service department practices cut them to a half. Federal income taxes take half the balance. In re-determinable contracts, profit is not fixed until late in performance or after completion. Then taxes also take their share.

Only in incentive contracts and in firm fixed-price contracts has a contractor, through his own skill, a chance to make a profit larger than the average government-allowed profit. In the former, there is a ceiling on what he can make; in the latter, the next order's price will be reduced. In both, taxes again take their share.

In addition, most larger suppliers are subject to statutory renegotiation. This is on an annual billings and profit basis, not contract-by-contract. Final determinations are long after-the-fact, and are wholly subjective determinations by the Renegotiation Board, using no measurable standards.

The sum of all these has reduced the average profit, after taxes,

of defense contractors to less than three per cent of sales, and less than eight per cent of invested capital.<sup>39</sup> These figures are, in turn, less than half the national average of corporate profits from all sources, as reported periodically by the National Industrial Conference Board.

The absence of adequate profits from defense work is expensive to the government for, because of this, contractors must look more to the government to supply tools and facilities. More crucial, however, is that less than normal profit allowances are gradually weakening our defense establishment through plant depreciation and obsolescence.

### CONCLUSION

Defense procurement, as presently organized and conducted, inherently—and to some extent, inevitably—contains conflicts which create tensions and disagreements between those engaged in it as policy makers, procurement or fiscal officials, prime contractors, sub-contractors or suppliers. Some of these are overt and malignant; some are passive but capable of eruption at any time.

Some of these are between different parts of the government—such as the legislative versus the executive branches, the General Accounting Office versus the service audit agencies, the Armed Services versus the AEC or NASA, the contracting personnel versus the fiscal personnel, the planners versus the budget makers, the civilian versus the military officer, the Defense Department versus the civilian economy.

Some of these conflicts and points of tension are between business in general and the massive power and demands of the government. Profit limitations and statutory renegotiation in peacetime, disallowances of true costs, repetitive repricing, unilateral rights to change or to terminate, demands to approve make-or-buy decisions, subcontracting programs, overtime and shift scheduling, inspection and quality control, purchasing techniques all seem like overly onerous invasions of management's abilities and prerogatives. The seizure of patents and property rights without any, or only inadequate, compensation, and the zeal in setting up competitive suppliers are viewed with hostility and alarm.

The overriding of common law and contract rights and the use of raw power to delay payments seem to businessmen and to lawyers to be nibbles at the free enterprise system and its Constitutional pro-

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<sup>39</sup> This subject and analysis is the subject of a comprehensive treatment in an address by Mr. W. A. Neumann, President, Le Laval Separator Company, before a meeting of the Procurement Advisory Committee of the National Security Industrial Association, at Hot Springs, Va., on June 22, 1957, and in an address by the writer, entitled "The Role of Profits in Government Procurement," to the students in the Army Supply Management Course, Fort Lee, Va., on January 22, 1958. Copies are believed available at NSIA (as to the former) and Ft. Lee (as to the latter).

tections with dangerous and far-reaching consequences, and yet they fear to bring so important a customer to court to test the validity of these actions.

Subcontractors view prime contractor controls and demands with as much alarm as business generally feels toward the government, and seek to protect their corporate privacy and trade secrets at all costs.

Lurking throughout are the political conflicts and overtones which only partly are free from self-interest and personal aggrandizement.

#### WHAT CAN BE DONE

There are no easy or certain solutions, or ways in which these conflicts can be resolved and their resulting tensions lessened. Neither do they fall within any single pattern or group of patterns, nor do they appear in the same way from one time to the next.

Yet to recognize that conflicts do exist, and to understand the reasons why each opposing viewpoint is held, goes a long way toward successfully finding resolutions of them. A more careful analysis and study of them in academic atmospheres might lead to effective long-range solutions. Certainly new studies of organizational structures, both in and out of government, can help to decentralize authority and thus to hasten decision-making.

The public should pay more attention to what is going on and its implications to their economy, to their taxes, to their freedoms and to the rights of free enterprise to manage, to take risks, and to make and keep profits. Where legal concepts are apparently violated, or Constitutional guarantees are ignored or emasculated, these should be subjected to judicial review and determination. Lawyers can themselves aid clients in these decisions.

Finally, trust must be restored in government, in business and in individuals. If suspicion that individuals tend to be venal, that corporations are incapable of high ideals and patriotism, that men do not deal with each other truthfully, that politicians are not truly serving their country and the people to the best of their capabilities, are the only tenets we can live by—it would indeed be a sad world. The murderer makes the headlines, but millions are safe from murder every day. Let us look at the live and regal strength of our people, not their isolated failures, and trust each other. Then we can make a start at eliminating tensions, friction and red tape—and at saving millions of dollars wasted in defense procurement because of fear and suspicion.